INTERNAL REVENUE SERVICE
NATIONAL OFFICE TECHNICAL ADVICE MEMORANDUM

Number: **200247001**
Release Date: 11/22/2002
Index (UIL) No.: 2031.00-00, 691.03-00
CASE MIS No.: TAM-103003-02/CC:PSI:4

Taxpayer's Name:

Taxpayer's Address:

Taxpayer's Identification No:

Date of Conference:

LEGEND:

Decedent =
Date 1 =
a =
b =
c =
Appraisal Firm =

ISSUE(S):

Whether the value of Individual Retirement Accounts (IRAs) owned by Decedent should be discounted for estate tax purposes to reflect income taxes payable by the beneficiary upon receipt of distributions from the IRAs, and for lack of marketability.

CONCLUSION:

The value of Decedent's IRAs should not be discounted for estate tax purposes to reflect income taxes that will be payable by the beneficiaries upon receipt of distributions from the IRAs, or for lack of marketability.

FACTS:

Decedent died on Date 1. At the time of his death, he owned several individual retirement accounts (IRAs) described in section 408 of the Internal Revenue Code. The IRAs were funded with marketable securities and money market accounts with a total value of $a on the Decedent's date of death. Decedent's estate was designated as the beneficiary of the IRAs. Various individuals were designated as the beneficiaries of Decedent's estate.

Appraisal Firm hired by Decedent's executor appraised the IRAs at $b. This value reflects an aggregate c% discount for the potential income tax payable by the beneficiaries on IRA distributions, delays that might occur between the IRA custodian's receipt of a request for distribution and actual payment of distributions, and prohibitions on the transfer or the assignment of the accounts prior to distribution to the beneficiary.

LAW AND ANALYSIS:

Section 691(a)(1) of the Internal Revenue Code provides that the amount of all items of gross income in respect of a decedent which are not properly includible in respect of the taxable period in which falls the date of the decedent's death or a prior period (including the amount of all items fo gross income in respect of a prior decedent, if the right to receive such amount was acquired by reason of the death of the prior decedent or by bequest, devise, or inheritance from the prior decedent) shall be included in the gross income, for the taxable year when received, of: (A) the estate of the decedent, if the right to receive the amount is acquired by the decedent's estate from the decedent; (B) the person who, by reason of the death of the decedent, acquires the right to receive the amount, if the right to receive the amount is not acquired by the decedent's estate from the decedent; or (C) the person who acquires from the decedent the right to receive the amount by bequest, devise, or inheritance, if the amount is received after a distribution by the decedent's estate of such right.

Section 1.691(a)-1(b) of the Income Tax Regulations provides that the term "income in respect of a decedent" refers to those amounts to which a decedent was entitled as gross income but which were not properly includible in computing the decedent's taxable income for the taxable year ending with the date of the decedent's death or for a previous taxable year under the method of accounting employed by the decedent.

Section 691(a)(3) provides that the right, described in section 691(a)(1), to receive an amount shall be treated, in the hands of the estate of the decedent or any person who acquired such right by reason of the death of the decedent, or by bequest, devise, or inheritance from the decedent, as if it had been acquired by the estate or such person in the transaction in which the right to receive the income was originally

derived and the amount includible in gross income under section 691(a)(1) or (2) shall be considered in the hands of the estate or such person to have the character which it would have had in the hands of the decedent if the decedent had lived and received such amount.

Section 691(c) provides that a person who includes an amount in gross income under section 691(a) shall be allowed, for the same taxable year, as a deduction an amount which bears the same ratio to the estate tax attributable to the net value for estate tax purposes of all the items described in section 691(a)(1) as the value for estate tax purposes of the items of gross income or portions thereof in respect of which such person included the amount in gross income (or the amount included in gross income, whichever is lower) bears to the value for estate tax purposes of all the items described in section 691(a)(1).

Section 2031 provides that the value of the gross estate of the decedent shall be determined by including the value, at the time of the decedent's death, of all property, real or personal, tangible or intangible, wherever situated.

Section 20.2031-1(b) of the Estate Tax Regulations provides that the value of every item of property includible in a decedent's gross estate under sections 2031 through 2044 is its fair market value at the time of the decedent's death, except that if the executor elects the alternate valuation method under section 2032, it is the fair market value at the date, and with the adjustments, prescribed in that section. The fair market value is the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of relevant facts.

In Estate of Robinson v. Commissioner, 69 T.C. 222 (1977), during her lifetime, the decedent sold stock in exchange for a promissory note. The decedent properly elected to report the gain on this sale ratably as each payment was received, under the installment method pursuant to section 453. The decedent died before the note was satisfied. In determining the value of the note includible in the gross estate, Decedent's executor discounted the note to reflect the potential income taxes that would be payable on receipt of subsequent installment payments. The court concluded that under the "willing buyer-willing seller" standard of the regulations, property is to be valued at the price a hypothetical willing buyer would pay a willing seller and not the intrinsic value of the property in the hands of the individual decedent or his beneficiaries. In this case, on purchase of the note, a willing buyer's basis in the note would be increased to the purchase price, and thus, the buyer would not incur any income tax on receipt of the installments. The fact that the willing seller might incur income tax on the sale of the note does not impact on the sales price. Accordingly, a willing buyer would not take potential income tax into account in determining what he would be willing to pay for the note, and a willing seller would not accept any discount for potential income tax in determining the price of sale. The court also noted that

taking potential income tax into account would require consideration of many factors that are peculiar to the individual decedent, the decedent's estate and the beneficiaries. Consideration of these subjective factors would not be consistent with the "willing buyer-willing seller" standard that looks to hypothetical parties.

Finally, the court in Estate of Robinson stated that Congress focused on the problem of income tax inherent in certain assets included in the gross estate by allowing an income tax deduction under section 691(c). As discussed above, section 691(c) provides an income tax deduction determined by reference to the estate tax attributable to the assets. The court reasoned that Congress recognized that an installment obligation which includes income in respect of a decedent is subject to both income tax and estate tax. Congress chose to ameliorate the impact of the income taxation of the property by allowing an income tax deduction under section 691(c). The court found that there was no basis for supplementing this income tax relief with additional estate tax relief.

We believe the court's rationale in Estate of Robinson is equally applicable in the instant case involving Decedent's IRAs. As was the case in Estate of Robinson, the fact that these assets are subject to income tax on distribution, should not impact on the application of the "willing buyer-willing seller" standard. The IRA distributee can sell the assets at market price without any discount. A willing seller would not accept any discount on the sales price. The situation is analogous to that presented where a donor transfers low basis property by gift. The value of the gift for gift tax purposes is the undiscounted value of the property because that is the amount a willing buyer would be willing to pay for the property, and it is also the minimum amount for which the willing seller would sell the property. The fact that the donee might incur income tax upon a later sale of the property does not decrease the value of the gift, which is determined under the "willing buyer-willing seller" standard.

Further, as was the case in Estate of Robinson, the adverse impact of the potential income tax inherent in the IRAs is alleviated by the section 691(c) deduction. Thus, this income tax benefit functions as a statutory substitute for the valuation discount. Under these circumstances, any additional reduction in estate tax for the potential income tax would be unwarranted. See Estate of Robinson, 69 T.C. at 226 - 227.

Finally, the value of the IRAs should not be discounted due to lack of marketability. While section 408(e) imposes penalties on the transfer or assignment of the IRA, there are no restrictions preventing the distribution of assets to the beneficiaries after decedent's death. The beneficiaries can request that the custodian distribute the assets of the IRAs and the beneficiaries can then sell the assets to any willing buyer. Furthermore, short administrative delays in processing the beneficiaries' request for distribution should not warrant a discount. The underlying assets are

marketable, so no valuation discount should apply. Accordingly, the value of Decedent's IRAs should not be discounted for estate tax purposes to reflect income taxes that will be payable by the beneficiaries upon receipt of distributions from the IRAs, or for lack of marketability.

The estate cites Eisenberg v. Commissioner, 155 F.3d 50 (2d Cir. 1998). In Eisenberg, the taxpayer transferred shares of her closely held corporation to her son and grandchildren. On her gift tax return, the taxpayer discounted the value of the gifts to reflect potential capital gains tax liabilities that may be incurred if the corporation liquidated, or distributed or sold its appreciated assets, even though no liquidation or distribution was planned at the time of the gift. The court held that with the repeal of the doctrine of General Utilities & Operating Co. v. Helvering, 296 U.S. 200 (1935), by the Tax Reform Act of 1986, neither the corporation, if it sold the assets, nor a shareholder, if he liquidated the corporation, could avoid imposition of capital gains tax on the appreciated assets. The court applied the "willing buyer-willing seller" standard and determined that a hypothetical buyer would take the corporation's built-in capital gains tax liability into account in determining the value of the stock. The Service acquiesced in Eisenberg to the extent that it holds that a discount for potential capital gain tax is not precluded as a matter of law. A.O.D. 1999-01. However, the applicability of such discounts are factual matters to be determined on a case by case basis. See also, Estate of Davis v. Commissioner, 110 T.C. 530 (1998).

The situation in Eisenberg is distinguishable from the facts in this case. Upon sale of the stock of the corporation, a hypothetical buyer of the stock in Eisenberg will obtain a cost basis for the stock that he purchases, but the corporation's basis in its assets will not change. When the corporation liquidates or distributes the assets, a capital gains tax will be imposed. This potential liability reduces the inherent value of the corporation to the buyer. However, in the instant case, if we assume arguendo that the IRAs could be sold, the hypothetical buyer, as in Estate of Robinson, would receive a cost basis in the assets and would not incur any income tax on the resale of those assets, unless the assets appreciate in value. Therefore, the hypothetical buyer will be willing to pay the full value of the underlying assets for the IRA. Although the seller might incur income tax on the sale (see section 408(e)(2)), this income tax liability cannot be the basis for an estate tax valuation discount.

Further, we do not believe that for valuation purposes an IRA is properly viewed as a separate entity, like a corporation. Rather, an IRA is a custodial arrangement and the stocks, bonds, and mutual funds held in the IRA are properly viewed as individual assets no different than stocks and bonds held in a brokerage account.

Finally, and most significantly, Eisenberg did not involve a situation where the adverse impacts of the potential income tax is alleviated by the section 691(c) deduction as is the case here. As discussed above, we believe that this deduction is a

statutory remedy for the adverse income tax impact and makes any valuation discount inappropriate, if the deduction applies.

The estate also cites Estate of Smith v. Commissioner, 198 F.3d 515 (5th Cir. 1999), rev'g 108 T.C. 412 (1997), nonacq. 2000-19 IRB 1 (May 8, 2000). In Estate of Smith, prior to his death, the decedent had been paid oil and gas royalties and had reported the payments as income. Subsequently, the corporate payor of the royalties sued the decedent for $2.48 million dollars, claiming the payments had been excessive by that amount. The proceeding was still pending at the time of decedent's death. Fifteen months after decedents' death, the estate settled the suit for $681,840. The estate claimed a deduction under section 2053, as a claim against the estate, for $2.48 million, the amount the decedent was being sued for at the date of death. The Fifth Circuit held that the amount deductible was the value of the claim as of the date of death determined without consideration of the post-death settlement. Further, the Fifth Circuit concluded that the income tax benefit inuring to the estate under section 1341 (providing relief in the form of an income tax deduction or credit to taxpayers who are forced to repay an amount previously taken into income) was one of the factors to be considered in valuing the claim, and was not to be included as a separate asset, as the Tax Court had concluded. Similarly, in the instant case, it could be argued that tax benefit available under section 691(c) is merely a factor to be taken into account in determining the appropriate discount.

However, as discussed above, section 691(c) specifically addresses income tax inherent in assets that are also subject to estate tax and provides a statutory remedy, a reduction in income tax, to alleviate the situation. This income tax reduction operates in lieu of an estate tax reduction in the form of a valuation discount. In view of section 691(c), the Fifth Circuit's approach in Estate of Smith would not apply in the instant case.

CAVEAT(S)

A copy of this technical advice memorandum is to be given to the taxpayer(s). Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.